Success in staying the course

Trade finance gaps in the hundreds of billions across the globe, bank bailouts amounting to nationalisations, retrenchments to domestic markets and outright exit of mid-tier banks from international banking: the trade finance map is being re-drawn, yet in that difficult context, the Canadian banking and trade finance environment is robust – even thriving. Alexander R. Malaket speaks with leaders in Canada's trade finance sector to illuminate a bright spot in global trade finance.

Banking on the Canadian model

Canada, like many nations, is currently battling a recession, fighting to preserve important industry sectors such as the automotive sector, and working to respond to the downward spiral in the global demand for commodities, including oil and gas.

Unlike several economic powers however, Canada is not facing a financial-sector crisis requiring billions in government bailouts, public sector intervention in the running of banks and insurers, crisis-driven M&A activity, or the need to re-evaluate the regulatory model under which Canadian institutions operate.

Despite the proximity to the US - both geographic and commercial - Canadian financial institutions and investors did not become embroiled in the sub-prime mortgage crisis, nor did they suffer as badly as others from the evaporation of confidence in the interbank markets, which caused the global credit engine to seize up and stall out.

Eduardo Klurfan at Scotiabank in Toronto

The debate which framed the recent G-20 meeting in London - regulation versus stimulus - is one which was unnecessary in Canada, given that the regulatory context has always been, and remains, effective and prudent. Stewardship has been a watchword for bank and financial sector executives, to the extent that senior leaders in the Canadian market have historically been taken to task for being too conservative, plodding and unimaginative. Under the current crisis however, the careful management of the financial sector, by regulators as well as executives, is being recognised across the globe, and celebrated, tactfully, in Canada.

The exposure of Canadian financial firms to 'toxic assets' is relatively limited and has been accounted for; there is no material impact from the activities of unregulated and risk-oriented hedge funds, and the regulatory regime has remained effective through the current crisis. It is no coincidence that quiet conversations have taken place between Canadian officials and several countries seeking counsel on financial sector regulation, and no surprise that retired Canadian bank regulators have been cultivating lucrative international consulting engagements, long before the current crisis spread like wildfire across the globe.

This is the context within which Canadian trade finance operates, and the environment from which it will perhaps reach a next level of profile, maturity and impact, both domestically and internationally.

Trade finance, Canadian style

Canadian trade has historically been highly concentrated, with over eighty percent of flows involving the United States, and with major sectors, and a relatively few major players, dominating the market. Equally notable is the reality that intra-company trade remains an important element of cross-border commerce, and that most business has been done on open account terms, long before doing so became the norm in other markets.

The Canadian trade environment involves world-class companies such as Bombardier and SNC Lavalin, global leaders in transportation and engineering, as well as the unique value proposition developed by Export➤

Scott Shepherd at Northstar in Richmond

Angela Wasylynka at Nextrade Finance in Saskatoon

➤Development Canada (EDC), the national export credit agency (ECA), widely acknowledged as one of the top agencies in the world.

Trade finance is provided largely by Canadian banks, with a few international institutions active in the market, though some of those have retreated to their own domestic markets and effectively 'given back' their market shares to the primary providers. For most Canadian banks, trade finance is an ancillary service rather than a core, strategic offering, and its fortunes within the broader financial institution follow those of the bank's corporate or commercial finance business.

A recurring service gap relative to SME's (which persists despite the rhetoric from many sources about the importance of small business in Canada) has motivated the creation and growth of unique trade finance providers such as Northstar Trade Finance, an innovative partnership of bank, government and private sector shareholders.

Scott Shepherd, president and CEO of Northstar, headquartered in British Columbia, notes: "Despite the retreat of many financial institutions from international banking, Northstar enjoys the full support of all our shareholders. We have retained or expanded our credit facilities, and continue to offer a strong value proposition to our clients. We are actively working to extend our export finance capabilities internationally, on the foundation of our Canadian model."

Northstar has extended its approach to the US, the UK, Europe and Australia, and is one of only three trade financiers worldwide to qualify under the US Ex-Im Bank Delegated Lending Authority Programme. Northstar`s 16-year partnership with EDC in Canada is also a unique element of the company's highly successful model.

Trade banking and the global crisis

Fundamentals in Canada are relatively healthy; while we have undertaken deficit spending to provide stimulus, the expectation is that we will avoid a systemic problem, and that our recovery will be accelerated relative to other jurisdictions. In that context, our trade finance banks are viewed very favourably, and have been approached to help reduce the risk profile of certain transactions through confirmation of letters of credit (LCs), or indeed, issuance of LC's on behalf of other, less robust institutions.

The 'flight to quality' in financial services has resulted in Canadian trade banks attracting new business, both domestically and through their international operations. In fact, the margins commanded by solid trade banks have been very attractive, more than offsetting the absolute reduction in trade volumes, to generate record revenues and convincingly illustrate the counter-cyclical nature of trade finance as a business.

While many, certainly in North America, wrestle with conflicting views about the increase in government intervention engendered by the crisis, the situation in Canada has resulted in a more positive, complementary dynamic between Canadian banks and the national ECA.

EDC and the banks had, for years, operated as partners, while an undercurrent of resentment flowed through the relationships, as the banks viewed EDC as competing unfairly against them in financing trade. By all accounts, the agency's, and the government's response to the crisis has been thoughtful and measured, and appears to have generated positive energy and trust between key players in the market. This translated directly to the development of effective risk and financing solutions devoid of bureaucracy, leveraging the existing delivery platforms of the banks together with the mitigation capabilities of a top-tier ECA.

This development could be one of the most important long-term consequences for trade finance in Canada.

At the level of the financial institutions, trade finance has enjoyed an increased positive profile, a new interest among senior executives, and a level of support - including access to credit - which has enabled trade financiers to grow their businesses at a time when other lines of business are in decline. Even as calls for reform in Basel II are heard across the globe, the favourable capital profile of the trade business is finally becoming apparent to non-trade bankers in Canada. It helps that Canadian banks are not distracted by issues around staffing, executive compensation, credit quality and M&A activity.

While some maintain that the fundamental nature of trade banking in Canada will not change drastically, others see a more transformational vision. For Scotiabank, the strength of the institution's international franchise, coupled with the current circumstances, present an opportunity. Eduardo Klurfan, vice president, trade finance and financial institutions at Scotiabank in Toronto notes: "We are shifting from a 'hub and spoke' view of our business, with Canada as the hub, to more of a network view of trade finance across the many markets where we operate."

Cristian Mandachescu, vice president, trade services and financial institutions, at Scotiabank in Toronto, adds: "While many providers of trade finance have retreated, we have been able to take the opportunity to advance, based on a very focused approach to trade finance. In theory, we could grow as much as we wish to. We have been presented with a significant number of new trade finance opportunities, however, we are managing our growth exercising restraint and focusing on sound risk management."

Canadian banks are now competing on the strength of their balance sheets, against institutions in the US, the UK, the Netherlands and elsewhere, that have effectively been taken over by government and therefore arguably represent sovereign risk. Despite this, Canadians are quite happy to communicate the state of their sector and institutions, and welcome the opportunity to demonstrate the health and transparency of the system, at a time when confidence is a critical factor in shaping the market.

We have observed the commoditisation of trade finance offerings for many years, as well as a more recent disintermediation of banks in international trade, however, the current crisis has - at least momentarily - reversed both trends, certainly in Canada.

The careful selection of relationships, by corporates and by banks, based upon a longer-term view, together with relationship-pricing, are both realities of the market today.

Canadian bankers confirm a shift back to traditional trade finance products, primarily documentary letters of credit, leveraged both for their risk mitigation properties and the discounting and financing options which they provide. LC discounting volumes are up, and Canadian trade banks note that there is a clear shift from financing based on corporate risk (straight loans or working capital solutions) to financing based upon bank risk through letters of credit and the discounting of term drafts.

There is a solid consensus that banking activities, including trade finance, must remain market-driven and client-responsive, as opposed to being influenced by artificial demands to lend in the absence of demand, or at the expense of quality. Canadian bankers are happy to point out, gently, that they appear to have 'gotten it right' as far as sound management and prudent credit adjudication.

Opportunity in crisis?

Does a return to traditional products signal the end of a nascent spirit of innovation in trade finance? While it might be tempting to revert to long-established business models in light of the global crisis, the trade finance team at the Bank of Montreal (BMO) sees an imperative to continue to innovate.

Sara Joyce, executive managing director, global trade finance at BMO in Toronto, observes: "The current crisis has emphasized for many retailers and manufacturers the need to support key suppliers whose access to pre and post shipment finance has been constrained. Our clients also continue to need to reduce their own costs and cycle time, and to free up working capital for other purposes. As part of our ongoing efforts to develop tangible value propositions around supply chain finance and open account procurement, we are working closely with internal and external partners to devise integrated working capital solutions to meet a wide range of customer needs."

Sara Joyce at Bank of Montreal in Toronto

BMO has seen a greater interest in its delivery capabilities in the US, including through its Harris Bank subsidiary. Craig Travelstead, head of trade sales US in Chicago for BMO, notes: "We have increasingly been approached to confirm LCs issued by large US banks and to issue LCs on behalf of regional mid-tier institutions. Our financial strength, combined with our continued innovation in supply chain and open account, are keeping us in discussions for new trade finance opportunities, above and beyond our traditional client base."

Overall, the Canadian trade banking and trade finance environment mirrors the health, potential and positive energy of the country's financial sector. Leading providers are actively looking to extend their capabilities, continuing to innovate, and consciously bridging the gap between traditional products and the trade finance solutions of tomorrow.

A convincing illustration of the robustness of the sector is perhaps the success of a small, niche trade finance provider – Nextrade Finance – affiliated to the Saskatchewan Trade & Export Partnership (STEP), the provincial trade promotion organization. The Canadian Prairie Province, home to just over 1 million people, has recently become the largest exporter in Canada on a per capita basis, and is enjoying a surge of prosperity despite the global crisis. Saskatchewan may be the only jurisdiction in North America that is projecting a budget surplus, and Nextrade Finance is commensurately effective in supporting the smallest of SME`s in need of trade finance. Nextrade has surpassed C$10 million in (total) financing support, primarily low-cost factoring, with deal sizes averaging C$45,000–C$60,000.

Angela Wasylynka, director, international finance and logistics at Nextrade, points out: "While we do pursue positive returns, our public policy mandate in support of small business is fundamental to the value we provide to our clients. The typical size and tenor of the deals we facilitate are such that we are not competing with banks and traditional providers, but rather, helping emerging Saskatchewan exporters to grow into more traditional banking relationships." Just as is true with the largest deals in Canadian trade finance, the role of EDC and private insurers in backstopping deals is critical and welcome at this niche, SME-focused end of the market.

Canada is open for business

The overarching message about Canadian trade finance is that the sector is open for business, and that many stars – from the regulatory environment to the increasing profile of trade finance, to the now healthier dynamic between banks and the ECA – are aligning to make Canada a rare bright spot on the map of global trade finance.

Canada is indeed open for business in trade finance, and as in other areas of the nation's global citizenship, Canada's trade finance footprint has the opportunity to become disproportionately large, as a result of the sector's relative health through the global crisis. ■